OMEGA HYDROCARBONS LTD.

1984 ANNUAL REPORT

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Company Profile

The Company was incorporated under The Companies Act of Alberta as Omega Natural Gas Co. Ltd. on September 4, 1958. By Certificate dated November 21, 1967, the name was changed to Omega Hydrocarbons Ltd. Present management assumed control in 1974.

In 1979, the Company successfully completed a public offering of 1,000,000 common shares at $6.10 per share.

The Company's share capital was changed in 1981 by creating a class of 10,000,000 preferred shares at $10 par value and increasing the number of common shares from 5,000,000 to 20,000,000. In 1982, the number of authorized common shares was increased to 60,000,000 and on December 30, 1982, the common shares were split on a three-for-one basis.

In April, 1984, the Company gave notice of a Normal Course Issuer Bid to purchase a maximum of 712,000 common shares of the Company. Those shares were purchased prior to December 31, 1984 and were cancelled. As at December 31, 1984, there were 13,076,380 common shares issued and outstanding. Those shares are held by 2,032 shareholders and 98% of the shares are registered in Canada.

The Company's activities are primarily the exploration for and the development and production of crude oil and natural gas in Western Canada with the largest developments at the present time being in the Waskada area of southwestern Manitoba and in southeastern Saskatchewan.

Annual and Special General Meeting

The Annual and Special General Meeting of the Shareholders of Omega Hydrocarbons Ltd. will be held in the Glenview Room of the Calgary Convention Centre at 120 - 9th Avenue S.E., Calgary, Alberta on Thursday, the 23rd day of May, 1985 at 2:30 p.m. (local time).

Directors

T. Jack Hall, Calgary
Douglas S. Morgan, Calgary
G. Edward Warriner, Calgary
Dennis E. Hall, Calgary

Officers

President — T. Jack Hall
Vice President Exploration — Joseph S. Irwin
Vice President Finance — John L. Maclagan
Vice President Production — George E. Patey
Secretary-Treasurer — Bonnie C. Hall-Staples

Head Office

Suite 1300 Sun Life Plaza III
112 - 4th Avenue S.W.
Calgary, Alberta T2P 0H3

Auditors

Thorne Riddell
Chartered Accountants
1200 Bow Valley Square Two
205 - 5th Avenue S.W.
Calgary, Alberta T2P 2W4

Registrar

The Canada Trust Company
505 - 3rd Street S.W.
Calgary, Alberta T2P 3E6

Transfer Agents

The Canada Trust Company
505 - 3rd Street S.W.
Calgary, Alberta T2P 3E6

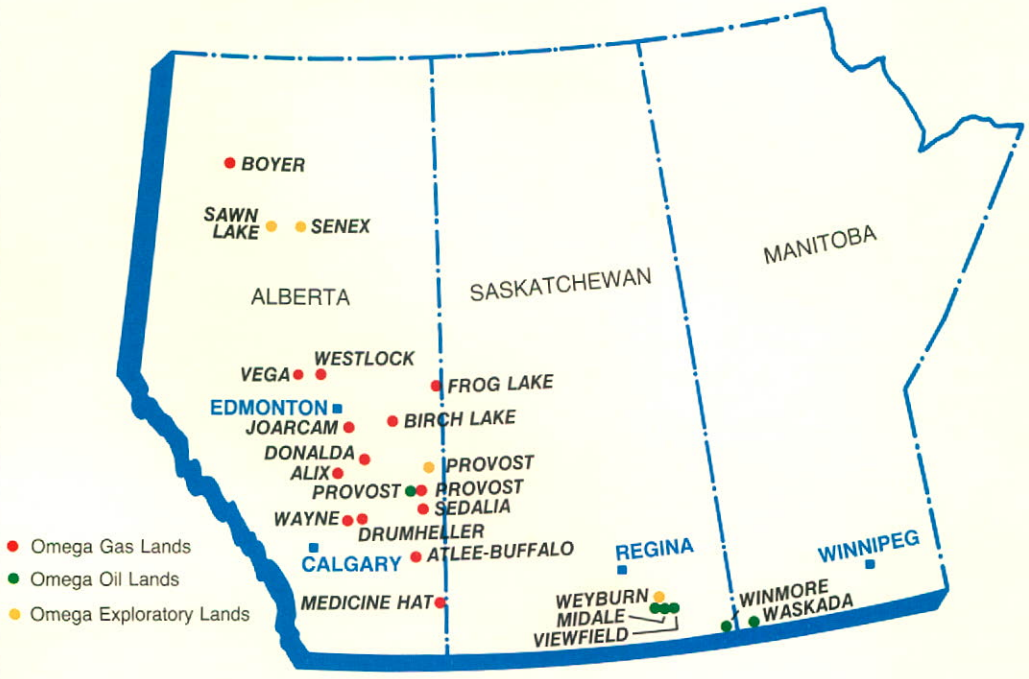
Solicitors

Howard, Mackie
700, 801 - 7th Avenue S.W.
Calgary, Alberta T2P 3S4

Main Bankers

The Toronto-Dominion Bank
Two Calgary Place
340 - 5th Avenue S.W.
Calgary, Alberta T2P 2P6

Highlights



Financial

	1984	1983	% Change
Revenue	**$52,725,000**	$45,370,000	+16
Cash Flow From Operations	**$30,216,000**	$32,894,000	− 8
— per share	**$ 2.24***	$ 2.38	− 6
— per share	**$ 2.31****	$ 2.38	− 3
Net Earnings	**$17,237,000**	$18,469,000	− 7
— per share	**$ 1.28***	$ 1.34	− 4
— per share	**$ 1.32****	$ 1.34	− 1
Capital Expenditures	**$38,831,000**	$35,727,000	+ 9

* based on weighted average number of shares outstanding
** based on number of shares outstanding December 31, 1984

Operations

(Company share before royalties)

Production of crude oil and natural gas liquids — barrels per day	**4,430**	3,776	+17
Sales of natural gas — mcf per day	**2,295**	2,225	+ 3
Natural gas reinjected at Waskada during the year — mcf	**95,100**	—	

Reserves

Proven reserves at December 31 (Company share before royalties)

Crude oil and natural gas liquids — thousands of barrels	**19,613**	15,760	+24
Natural gas — MMcf	**45,164**	45,050	—

T. Jack Hall,
President

To Our Shareholders:

The year 1984 was one of great challenge for the oil and gas industry. In September it became a year of historical significance when the Liberal Party, authors of the National Energy Program, was swept out of office. We enter 1985 with new hope for an improved economic environment and revitalization of our industry.

In spite of the industry's problems in 1984, Omega's results were rewarding and the year provided an opportunity to consolidate the excellent financial gains of the preceding few years. Revenues were significantly higher, the increase in asset base was impressive and additional staff was hired in order to provide for increased activity as well as geographic diversification of the Company's operations. Omega enters 1985 poised for growth and has the capability to take advantage of opportunities which will present themselves.

The Company's financial results are highlighted on the previous page and are displayed graphically on these pages.

Net revenue in 1984 grew at a satisfying rate, albeit not at the unsustainable percentage growth rates of recent years. The increase in revenue in 1984 was 16% compared to 119% for the previous year. Cash flow and net earnings were down slightly, mainly as a result of the greater impact of provincial and federal taxes.

The Company's capital expenditure program before incentive grants during 1984 was $39 million, up 9% from $36 million in 1983. During the same period Omega's bank debt increased to $28 million, over twice that at the beginning of the year. That increase reflects capital expenditures which exceeded cash flow, higher taxes, the cost of purchasing the Company's shares and reduction of the working capital deficiency at year-end.

The drilling program during 1984 again resulted in a greater number of wells being drilled than in the prior year. Omega participated in 153 wells, half of which were drilled in Manitoba, with an overall success ratio of 94%.

Omega's gross share of crude oil and liquid hydrocarbons production averaged 4,430 barrels per day compared to 3,776 barrels per day in 1983. During the month of March, 1985, Omega's production rates reached 4,945 barrels per day. The Company's gross gas sales in 1984 averaged 2.3 MMcf per day, essentially the same volume as in 1983.

The program at Waskada, Manitoba, including drilling, waterflood expansion and completion of the gas plant absorbed the largest percentage of the Company's capital spending. There will be ongoing drilling during 1985 and further expansion of the waterflood program which is progressing toward a field-wide scheme of secondary recovery.

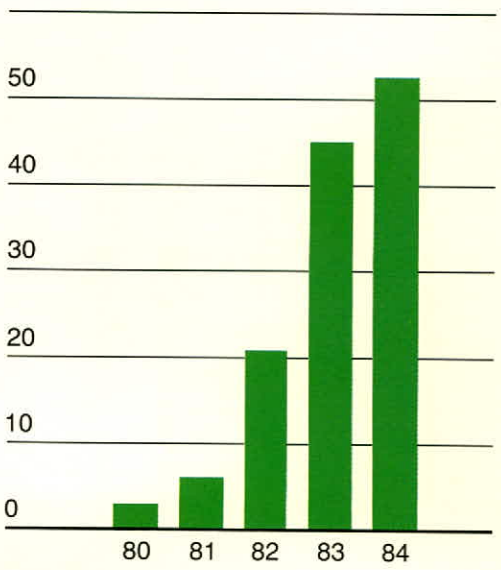
Omega committed itself to acquire a 30% participating interest in a crude oil pipeline from Waskada to Cromer at a cost of $1.4 million. The line was constructed in the latter part of the year and was placed on stream in January of 1985. This new facility should result in reduced transportation costs and should eliminate any possibility of shut down during spring road restrictions.

The enhanced recovery project at Provost, Alberta involved significant expenditures for drilling new wells and installing facilities. Most of the Company's Viking oil wells in the Provost field have been unitized into two unit areas. The 1984 program has been completed, water is being injected and enhanced production should become evident during the latter part of 1985 and early 1986.

Because of the gratifying results at Waskada, that field has required the largest portion of the Company's efforts and financial resources over the past few years. The Company has recognized the need to reduce its reliance on one area and has taken significant steps to accomplish that. As indicated by the production figures noted in

REVENUE

$ Millions



the operations review sections, drilling successes in other areas have brought crude oil and natural gas sales from those areas to approximately 25% of total revenue.

Realizing that more of its resources need to be directed to exploration and new developments, the Company has more than doubled its professional exploration and engineering staff during 1984 and to date in 1985. Additional employees have also been added in other departments in order to properly manage the increased levels of activity. At the end of March, 1985 the total number of employees in the field and in the Calgary office was 74. In order to accommodate the larger Calgary staff, the Company moved its headquarters to newly designed space in the Sun Life complex in September.

The outlook for 1985 has taken on a new perspective as a result of the recent announcement of the Western Accord of March 28, 1985. The Accord is an agreement between the western provinces and the Federal Government which is designed to remove the devastating effects of the National Energy Program. In particular, Omega is pleased to see the complete elimination of the Petroleum and Gas Revenue Tax on newly developed production after April 1, 1985 as well as the phasing out of the tax over the next few years. The length of the phasing out period is of course disappointing. The removal of this revenue tax will have a direct benefit on cash flow and net earnings over the ensuing years.

With its substantial cash flow and relatively low level of debt and with the larger and qualified employee group, Omega is well positioned to adapt to positive changes in the political/tax environment and take on new programs which will result in continued growth of the Company.

The Company was fortunate in acquiring the services of Mr. J. S. (Joe) Irwin as Exploration Manager late in 1984. Effective March 1, 1985, Mr. Irwin has accepted an appointment as Vice President, Exploration and the Board of Directors welcomes him in his new capacity.

The Board also welcomes each of the other new members of the staff and wishes to recognize herein the efforts of those employees who have been with the Company during the exciting periods of growth. It is to the efforts of its employees that the Company owes most of its success and we extend our thanks and appreciation for their hard work and dedication.

On behalf of the Board

T. J. Hall
President

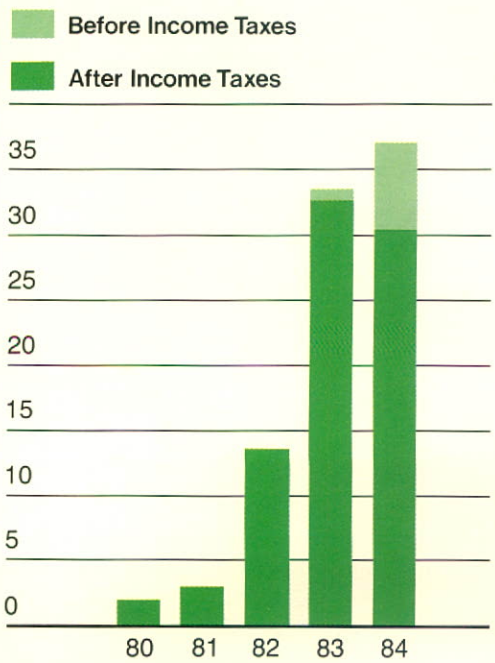
April 25, 1985

J. L. (Jack) Maclagan
Vice President Finance

Bonnie C. Hall-Staples
Secretary-Treasurer

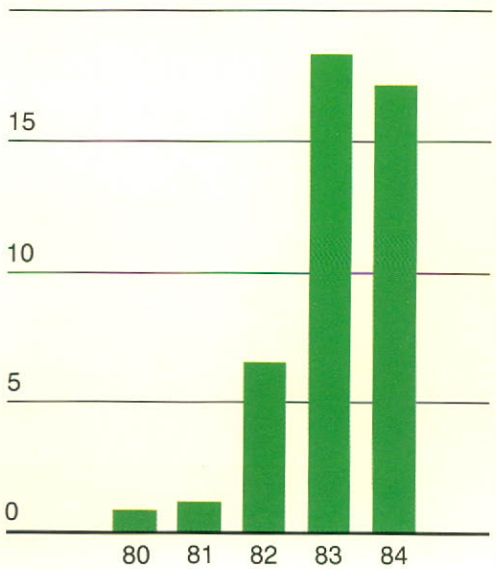
CASH FLOW

$ Millions



NET EARNINGS

$ Millions



Review of Operations

Joseph S. Irwin
Vice President Exploration

EXPLORATION

During 1984 and early in 1985, the Company expanded its capacity to carry on a much larger exploration program by adding professional staff which now includes five geologists. With this increased expertise, the Company can undertake more programs and will place more emphasis on developing prospects in Alberta. Efforts to acquire a land inventory in either oil or gas prone areas have commenced and will be escalated. Due to the Company's significant investment and success to date in Manitoba and southeastern Saskatchewan, an ongoing program will be maintained in those areas in an effort to find additional reserves at low cost.

Manitoba

In 1984, the Company drilled two wells in the Waskada area which encountered new Mississippian pools. These wells, along with two farmout wells drilled by other operators at no cost to the Company, are classified as exploratory probes. One of the farmout wells is in the Pierson area and has been completed as an oil well. Omega continues to recognize the potential that exists in the Tilston and Alida zones of the Mississippian formation and in deeper horizons in the general Waskada area. A detailed 68 mile seismic program was conducted in 1984 and prospects below the Spearfish are being considered for drilling in 1985 and 1986.

Saskatchewan

In conjunction with the Company's extensive oil development program of the Midale and Frobisher zones in the Weyburn and Midale North areas during 1984, four deeper exploratory step-out tests were drilled and completed in the Mississippian, Bakken sand zone. Although results of those tests have not met expectations, further evaluation of the Bakken zone, which has still not seen much exploration by industry, will be carried out in 1985 on the Company's significant land position in this area. In the meantime, dual zone completions in the Midale or Frobisher as well as the Bakken are being done on the Bakken wells which were successful in 1984.

In the Lake Alma area, Omega drilled and completed a Mississippian, Ratcliffe zone wildcat well. To date production results on this well are marginally economic due to high water cuts. A combination of better seismic control and expected industry activity may enhance our current land position in this area and could provide the Company with exploration opportunities in the deeper multiple zone potential of the Williston Basin of Saskatchewan.

At the end of 1984, Omega held 53,885 gross (52,830 net) acres of Crown and freehold mineral interests in Saskatchewan of which 9,460 gross acres are classified as developed lands.

The Company intends to continue an active Crown and freehold lease acquisition program on a 100% working interest basis in southeastern Saskatchewan.

Alberta

In the last quarter of 1984, Omega commenced a program to increase its exploration land holdings in Alberta. Focusing on the shallower areas of eastern Alberta, 13,440 acres of Crown lands have been acquired on a 100% basis in the Hansman Lake, Hayter, Rivercourse and Consort areas which are prospective for Lower Cretaceous Mannville zone oil and gas. A number of prospects are currently being developed for drilling in 1985.

Acreage has been acquired with partners on the Sawn Lake, Slave Point oil trend in northern Alberta. Omega has a 25% interest in a 6,400 acre license, 10 miles northwest of the prolific Sawn lake, Slave Point pool which is now being developed by other operators. Seismic data has been acquired preliminary to drilling attempts planned for the 1985/86 winter season.

Omega has acquired a 37½% interest in two Crown licenses containing 5,120 acres each in the exciting Senex-Peerless, Keg River oil play of north-central Alberta. The industry has focused on a widespread Crown acreage acquisition play based on significant high productivity, Middle Devonian, Keg River wildcat discoveries by two major companies in 1983. The objective is almost purely seismic-oriented and the trapping mechanisms appear to be quite local in nature. The new Senex (Panny Field) and Peerless discoveries are 40 miles apart, but are on trend with the Senex, Keg River "A" pool discovered in 1969. Although the area is extremely remote, drilling depths are reasonable, being less than 4,500 feet. Currently, Omega and partners are acquiring detailed seismic data on the joint lands with an exploratory drilling program expected during the 1985/86 drilling season. Wildcat tests drilled by major industry operators have been cased within a few miles of the northern and eastern boundaries of Omega lands and an apparent discovery is indicated eight

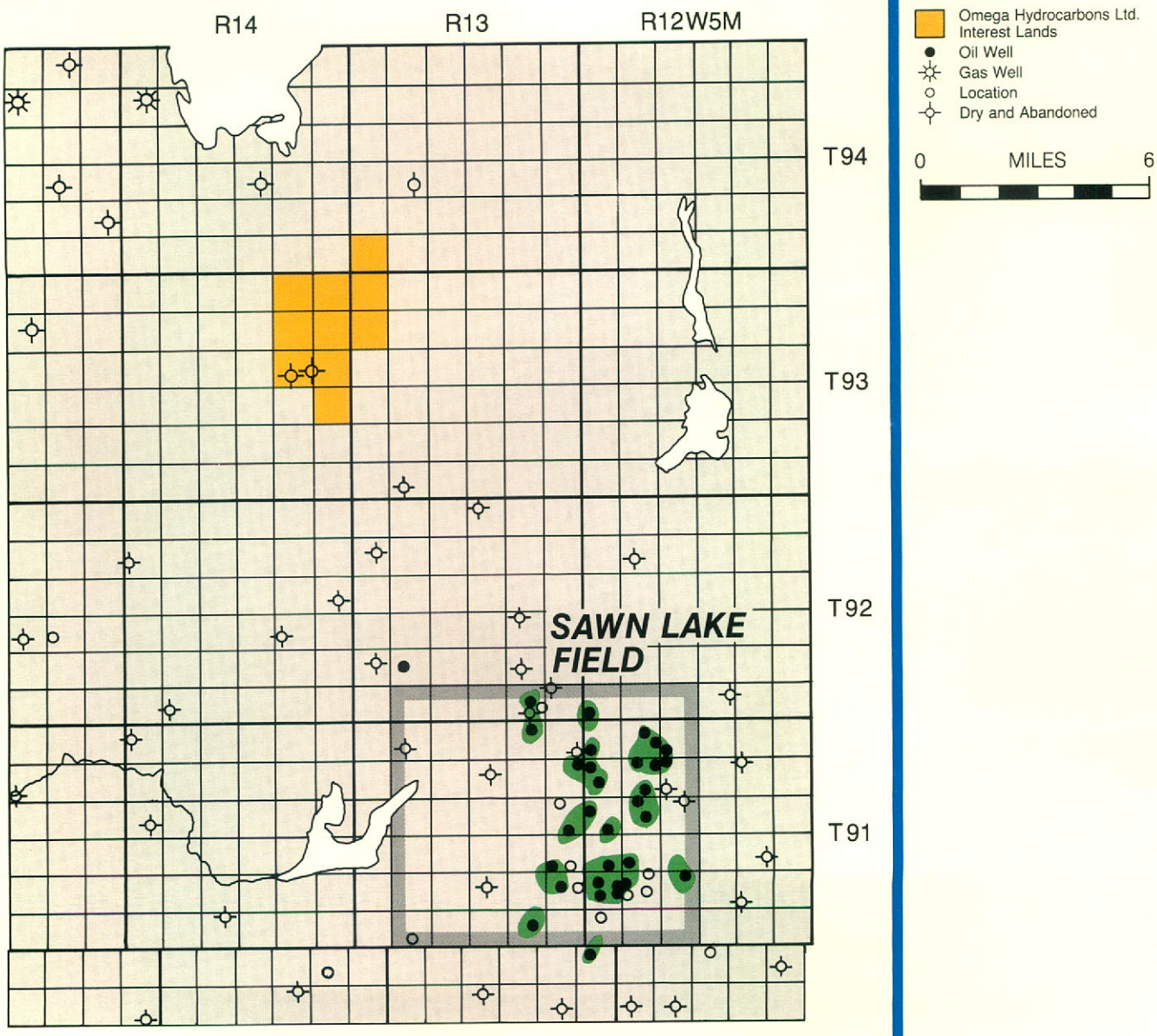
miles south of those lands. All data on the wells is being held confidential at present.

In the last quarter of 1984, Omega re-entered a previously abandoned well on a 100% owned 5,440 acre drilling licence in the Grizzly Area for purposes of evaluating potentially productive Lower Cretaceous gas zones. Although gas was not encountered in commercial quantities, testing of four individual zones has provided incentive for the Company to consider additional exploration in this area which is in the Deep Basin region of northwestern Alberta.

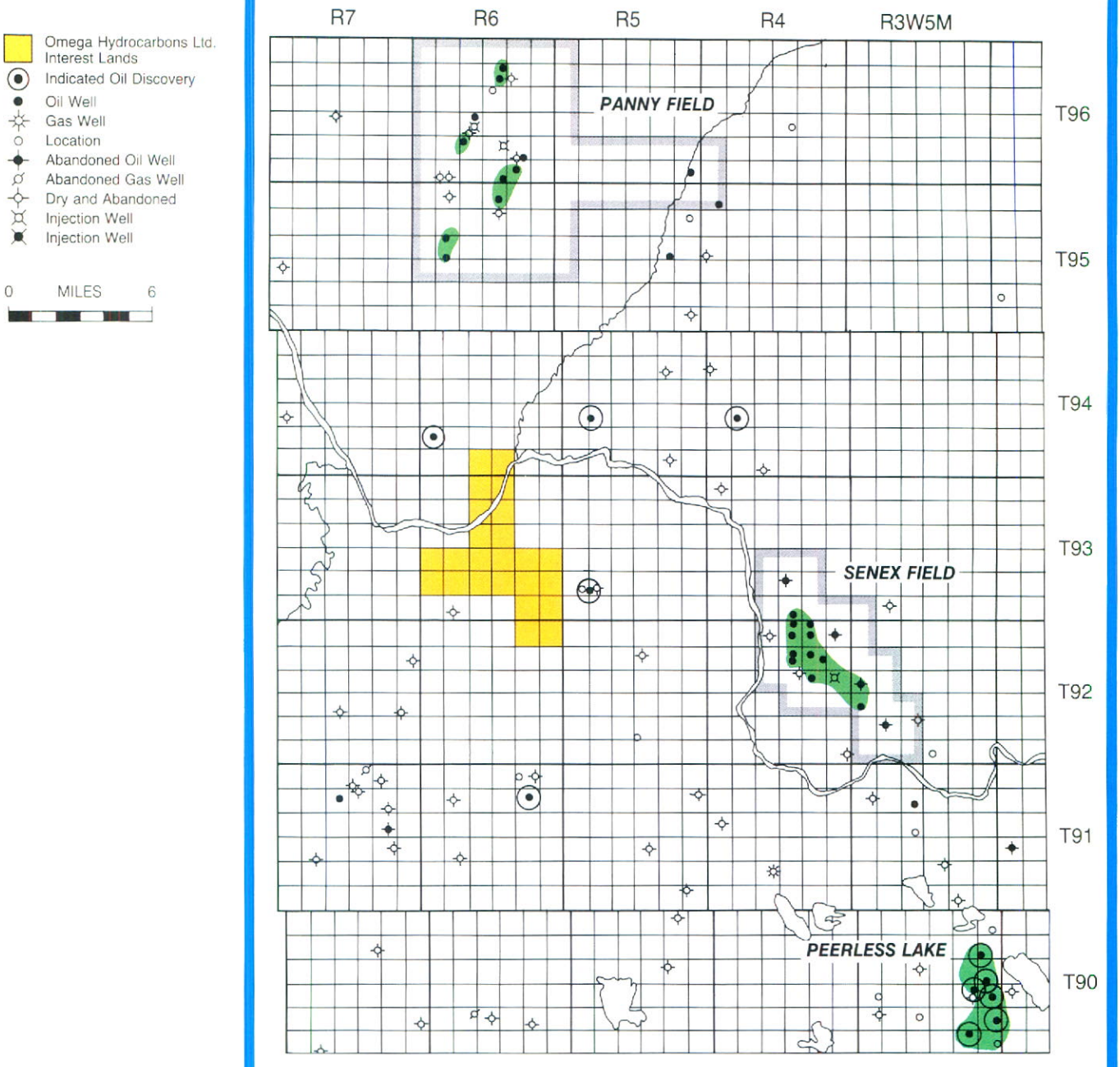
Outlook

With the addition of exploration staff and increased professional and support staff in the Production, Land and Finance Departments, Omega's ability to undertake new exploration projects has been significantly improved. The Company can be expected to become a more active and aggressive participant in the exploration sector of the industry.

Sawn Lake, Alberta



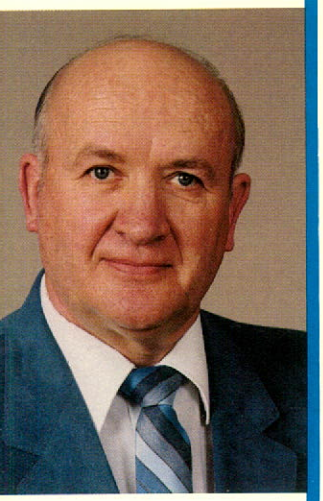
Senex, Alberta



Land Holdings (acres) as at:

	March 15, 1985			
	Gross		Net	
	Developed	Undeveloped	Developed	Undeveloped
Alberta	**106,897**	**92,272**	59,159	64,064
Saskatchewan	**9,460**	**44,425**	8,405	44,425
Manitoba	**13,943**	**27,336**	12,564	22,957
North Dakota	**960**	**9,460**	480	4,730
TOTAL	**131,260**	**173,493**	80,608	136,176

DRILLING, PRODUCTION AND RESERVES



George E. Patey
Vice President Production

Omega's capital expenditures during 1984 amounted to $38.8 million, before recognizing incentive grants, of which $18.6 million was spent on development drilling. Exploratory drilling accounted for $2.7 million.

During 1984, Omega participated in 153 wells (137 in 1983) of which 148 were drilled by the Company and five were drilled by others, four of those on lands farmed out by the Company. That activity resulted in 128 oil wells, one gas well, 14 water injection or water source wells, nine dry holes and one potential oil well which is presently suspended. Geographically, of the 153 wells drilled, 74 were located in Manitoba, 41 were in Saskatchewan and 38 were in Alberta. Sixteen of the wells drilled were exploratory tests, five in Alberta resulting in one gas well and four dry holes, seven in Saskatchewan resulting in five oil wells and two dry holes and four in Manitoba resulting in three Mississippian oil wells and one dry hole.

Omega's share of crude oil and natural gas liquids production averaged 4,430 barrels per day in 1984 compared to 3,776 barrels per day in 1983, an increase of 17%. Of the 1984 average, 3,544 barrels per day came from the Waskada field, 610 barrels per day was from Saskatchewan and 276 barrels per day was from Alberta.

Natural gas sales in 1984 averaged 2,295 mcf per day compared to 2,225 mcf per day in 1983.

Wells Drilled During the Year Ended:

	December 31, 1984		December 31, 1983	
	Gross Wells	Net Wells	Gross Wells	Net Wells
Oil	**128**	**114.3**	120	105.4
Gas	**1**	**.4**	10	7.0
Service	**14**	**9.7**	—	—
Suspended	**1**	**—**	3	2.0
Dry and Abandoned	**9**	**6.5**	4	2.0
TOTAL	**153**	**130.9**	137	116.4

Capital Expenditures

	1980	1981	1982	1983	1984
Land Acquisitions	$ 410,000	$ 3,987,000	$ 2,150,000	$ 1,678,000	**$ 2,045,000**
Drilling and Exploration	4,358,000	5,379,000	14,136,000	18,532,000	**21,699,000**
Production Equipment	3,630,000	3,049,000	11,538,000	15,517,000	**13,657,000**
Other Assets	—	—	—	—	**1,430,000**
Subtotal	8,398,000	12,415,000	27,824,000	35,727,000	**38,831,000**
Government Incentive Payments	—	(1,228,000)	(2,217,000)	(4,676,000)	**(4,219,000)**
NET	$8,398,000	$11,187,000	$25,607,000	$31,051,000	**$34,612,000**

Waskada, Manitoba

During 1984, Omega drilled a total of 72 (63.6 net) wells in this field. All of those wells were either producing or potential Lower Amaranth (Spearfish) wells and seven were completed for production from the Mississippian. To the end of 1984, the Company had drilled 304 wells in this field of which 255 wells are currently producing or capable of production.

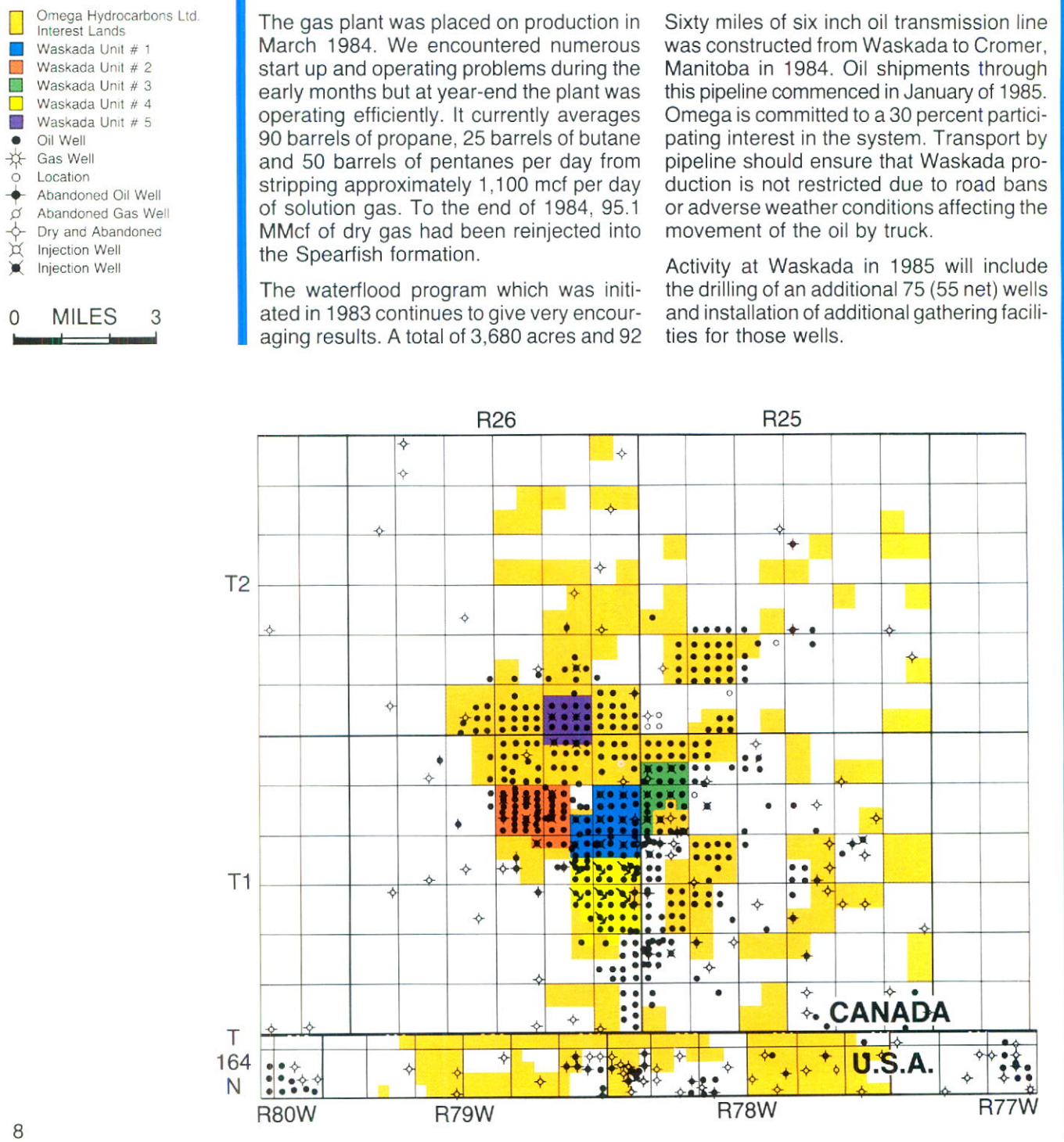
Gross field production before royalties for the year averaged 3,703 (Omega's share 3,462) barrels per day. This compares with 3,433 (3,372 to Omega) barrels per day in 1983.

The gas plant was placed on production in March 1984. We encountered numerous start up and operating problems during the early months but at year-end the plant was operating efficiently. It currently averages 90 barrels of propane, 25 barrels of butane and 50 barrels of pentanes per day from stripping approximately 1,100 mcf per day of solution gas. To the end of 1984, 95.1 MMcf of dry gas had been reinjected into the Spearfish formation.

The waterflood program which was initiated in 1983 continues to give very encouraging results. A total of 3,680 acres and 92 wells are now under flood and plans are underway to extend the program to include the entire field. Each section of the field drilled in the future will be placed under waterflood as soon as possible. The gas injection scheme has not resulted in the same improvement in production and therefore at least part of the gas injection area will be converted to waterflood. It should be noted that during the past two years, although 29 Waskada wells have been taken out of production for conversion to injectors, production from the field is increasing gradually. This results from the combination of new drilling and the improved production coming from enhanced recovery.

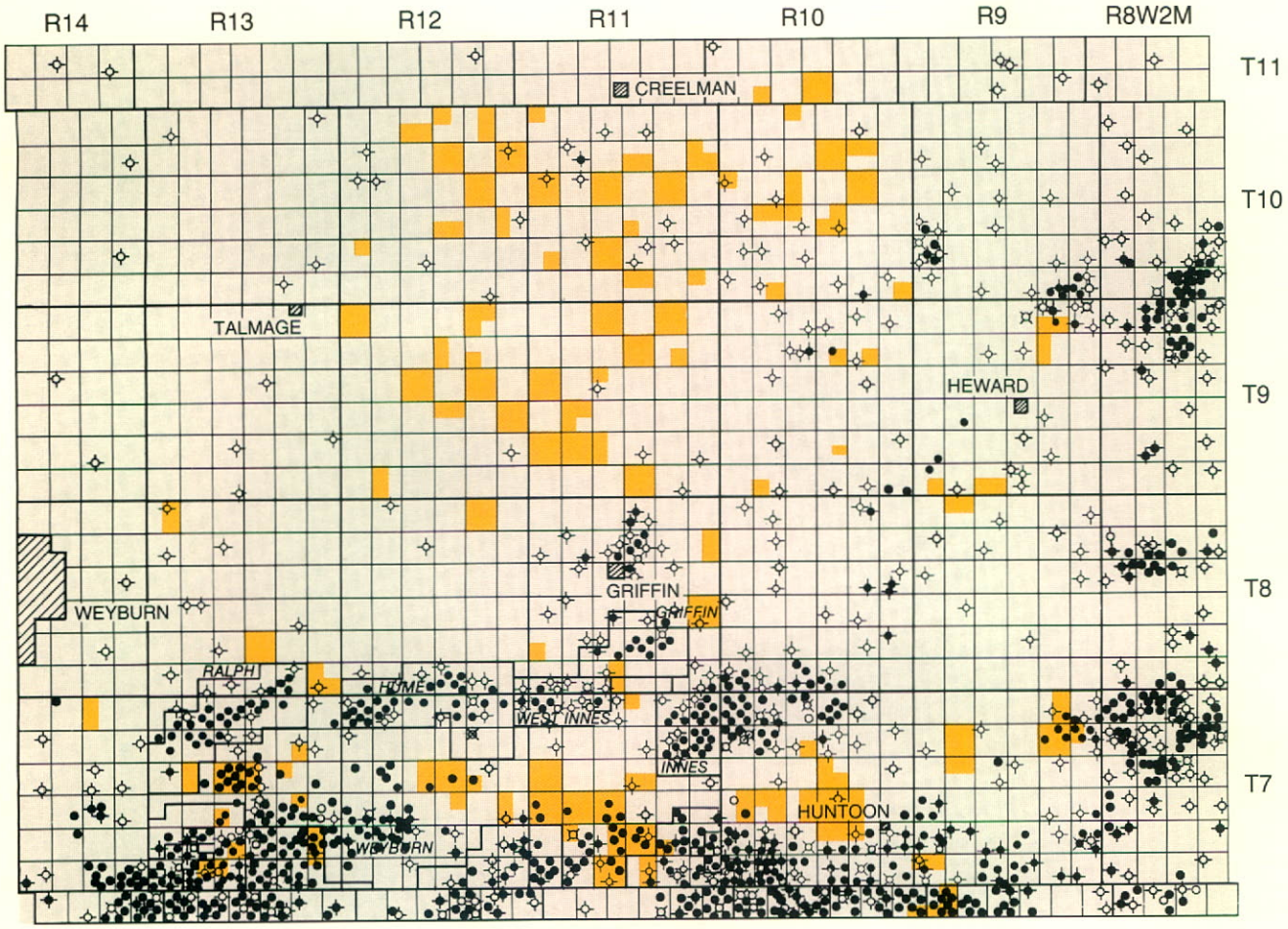
Sixty miles of six inch oil transmission line was constructed from Waskada to Cromer, Manitoba in 1984. Oil shipments through this pipeline commenced in January of 1985. Omega is committed to a 30 percent participating interest in the system. Transport by pipeline should ensure that Waskada production is not restricted due to road bans or adverse weather conditions affecting the movement of the oil by truck.

Activity at Waskada in 1985 will include the drilling of an additional 75 (55 net) wells and installation of additional gathering facilities for those wells.



Southeastern Saskatchewan

Omega operates 59 (55 net) wells in the southeastern area of Saskatchewan and plans to drill an additional 20 to 25 wells in 1985. The Company's share of production averaged 610 barrels of oil per day during 1984 and is currently at 945 barrels of oil per day. These production rates compare to average net production in 1983 of 167 barrels per day. Three batteries were constructed during 1984 and all but a few of the isolated wells were connected by pipeline to those facilities. We now have two water disposal systems and plan to initiate enhanced recovery programs by waterflooding the developed areas at Weyburn and Midale.



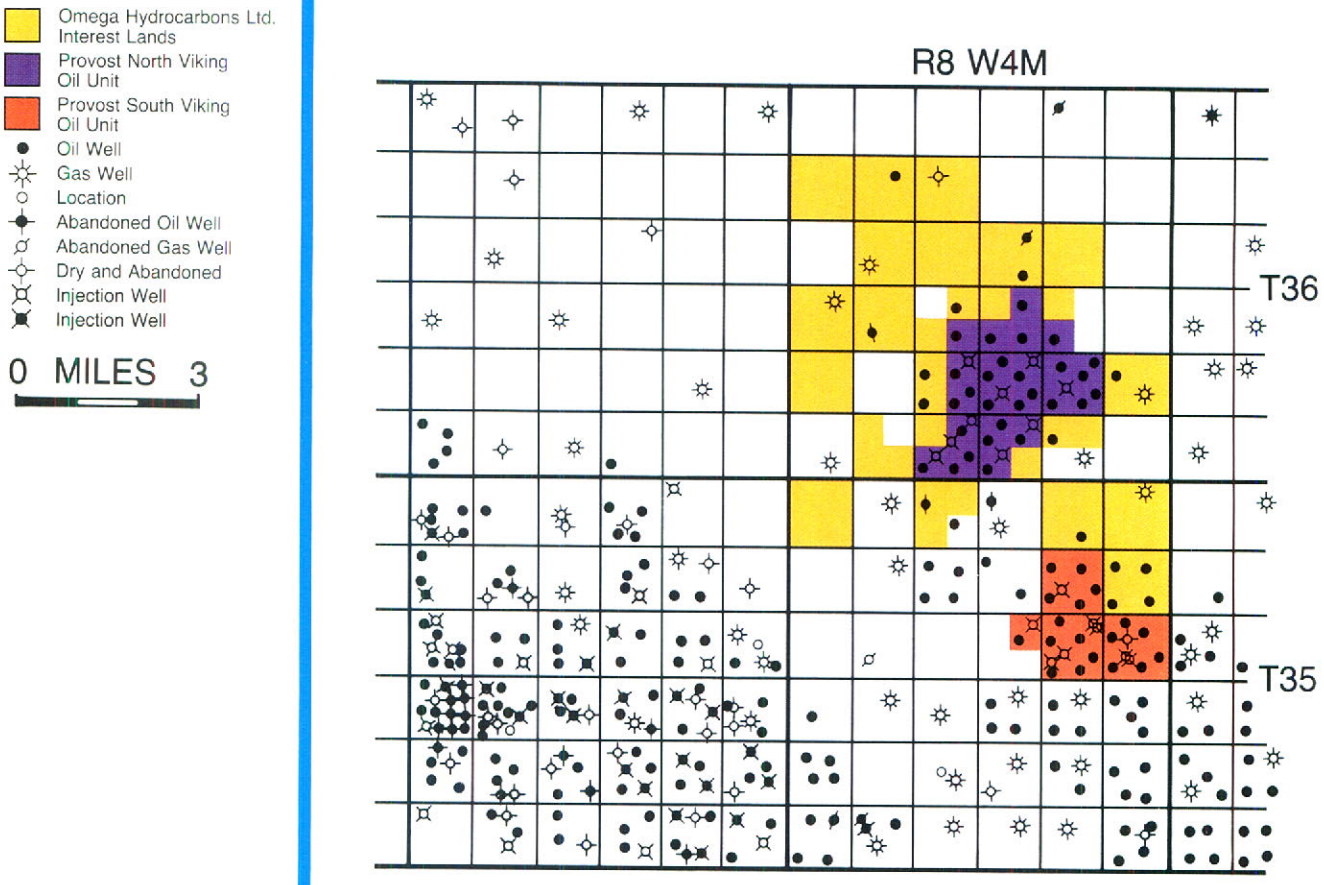
Omega Hydrocarbons Ltd. Interest Lands
Oil Well
Gas Well
Location
Abandoned Oil Well
Abandoned Gas Well
Dry and Abandoned
Injection Well
Injection Well

0 MILES 6

Provost, Alberta

In 1984, the Company drilled 33 (24.4 net) additional wells at Provost. The Company's share of crude oil and liquids production before royalties averaged 260 barrels per day compared to 230 barrels per day in 1983. Solution gas sales in 1984 decreased to 1,030 mcf per day from 1,230 mcf per day in 1983. As a result of the positive response to waterflood caused by the two pilot schemes, at December 31, 1984, Omega's share of gross production was 330 barrels per day of crude oil and natural gas liquids and 1,440 mcf per day of natural gas.

As a result of the encouraging performance obtained from the 1981 pilot tests, a full-scale nine spot waterflood was initiated in 1984. There are now 5,440 acres under flood which includes 46 producing oil wells. Water injection was commenced late in 1984. This enhanced recovery project is designed to provide considerable improvement in oil recovery and in operating revenues in future years.



Boyer, Alberta

Production from the 29 wells operated by Omega in this field averaged 1,300 (Omega's share 970) mcf per day in 1984 compared to 1,010 (720 to Omega) mcf per day in 1983.

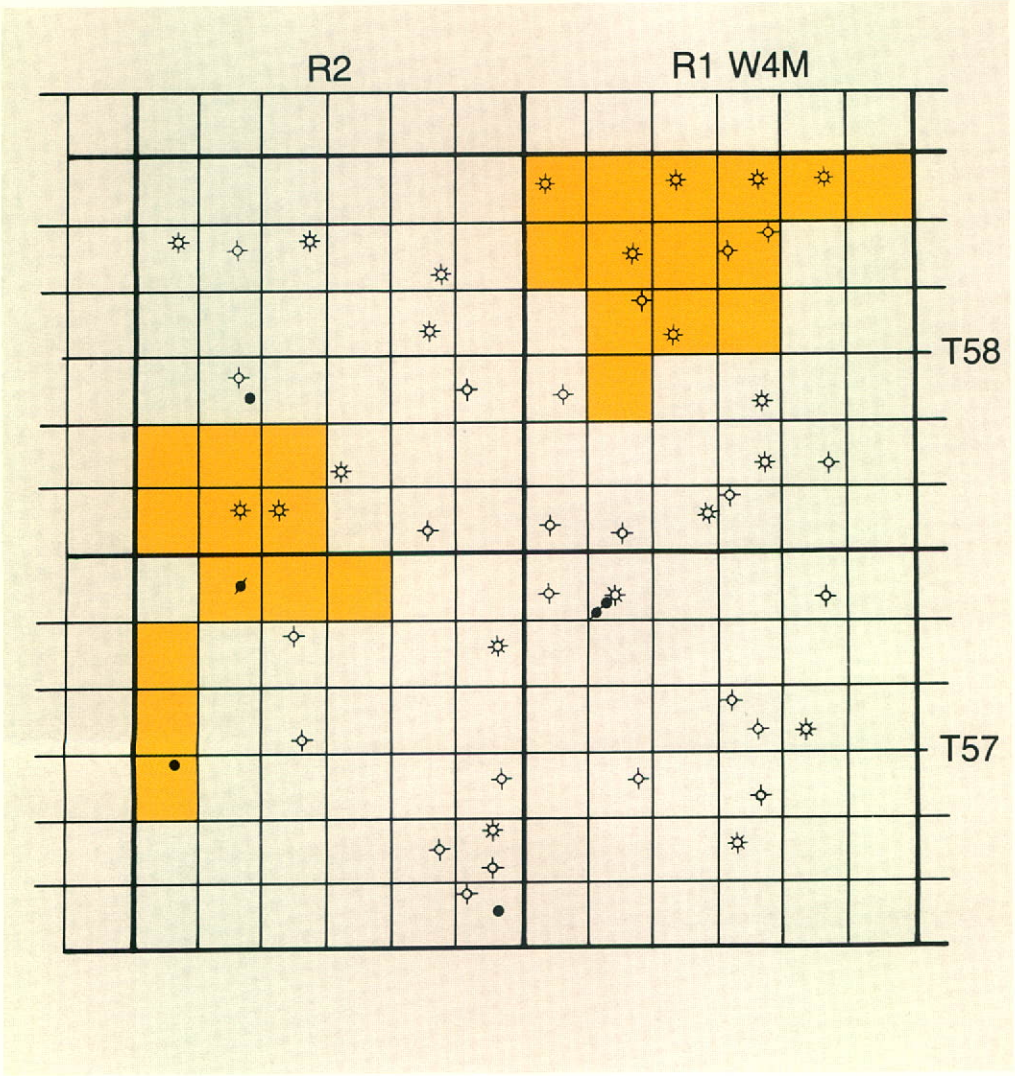
A reserve redetermination was carried out in 1984 which resulted in proven field reserves of 43 Bcf being recognized by TransCanada Pipelines. No additional work is planned for this area in 1985, although Omega's land holdings will provide for additional drilling timed to improving gas markets.

Frog Lake, Alberta

Omega's acreage holdings at Frog Lake consist of a 25% interest in 16,640 acres and a 50% interest in 640 acres. There are now seven shut-in gas wells, two producing gas wells and one Sparky oil well which is producing heavy oil. The operator of this property placed the oil well on production in late 1983 and it has produced economic volumes of oil continuously throughout 1984, using an upgraded conventional pumping method. A follow-up oil well is scheduled for early in 1985.

Late in 1984, the two gas wells were tied in and placed on production. The gas is being sold into the Cold Lake gathering system and volumes should average 2,850 (Omega's share 700) mcf per day.

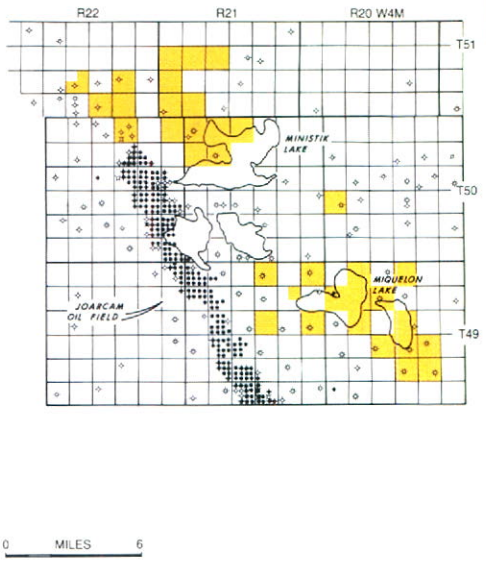
With the improved market possibilities for gas from this region, additional activity on the Company's land block may be generated as early as 1985.



Joarcam, Alberta

Only one well was drilled on Omega's large block of land in the Joarcam area during 1984 and it was dry and abandoned.

The lack of a market will further delay work in the area. The Company is hopeful, however, that ongoing efforts to find a market will meet with greater success during 1985. If that occurs, Omega would expect to drill additional wells to add to the 11 gas wells presently on Omega lands all of which are shut-in.



- Omega Hydrocarbons Ltd. Interest Lands
- Oil Well
- Gas Well
- Abandoned Oil Well
- Abandoned Gas Well
- Dry and Abandoned
- Injection Well
- Injection Well

Other Areas

Omega's plans to drill additional wells in North Dakota during 1984 did not materialize. Results from the wells previously drilled proved to be disappointing. Only one working interest well is now producing at marginal rates. At the present time the Company has no plans for further work on its lands in the area.

It is possible that further drilling could be commenced on the Company's Vega, Alberta lands later in 1985 but such activity will depend on the prospects for a market.

In addition to the areas highlighted in this report, Omega has producing oil and natural gas properties in Alberta at Birch Lake, Drumheller, Pembina, Sedalia and Westlock.

Future sources of revenue will accrue to the Company from properties on which natural gas reserves have been located but which cannot be developed until the prospects for additional natural gas sales from Alberta improve. These properties are located at Alix, Atlee Buffalo, Donalda, Joarcam, Medicine Hat, Wayne and Vega. Markets will also be pursued for the gas that is not required for reinjection at Waskada.

As indicated in the section of this report on exploration, Omega plans to increase its activities in new areas and in the evaluation of its interests in undeveloped land holdings. Successes from that activity will be followed up with development drilling at the earliest possible times.

Reserves

At the end of 1984, Omega's proved crude oil and natural gas liquids reserves, as calculated by independent petroleum consultants, are 24% higher than the estimates of the previous year and gas reserves are unchanged. These reserve volumes are substantial additions as they include replacement of production of 1.6 million barrels of crude oil and natural gas liquids and 1.5 billion cubic feet of natural gas. The Company's reserves of oil and gas are now located 59% at Waskada, Manitoba, 9% in Saskatchewan and 32% in Alberta. Of the net proven reserves added during 1984, 41% came from our Alberta and Saskatchewan programs. The drilling program at Waskada added 3.5 million barrels of new proved reserves.

Future cash flow from the Company's reserves, which is also calculated by independent petroleum consultants, is shown on the following table, undiscounted and discounted at various rates. The cash flow projections are moderately lower than those reported last year due to lower price schedules used in the projections, which reflect the weakening international oil price structure but do not take into account the benefits of the newly established Western Accord.

The values given in the table were calculated after deducting estimated royalties, production taxes, operating expenses and future capital expenditures estimated to be required to place the undeveloped and probable reserves on production but do not include the effect of income taxes.

Petroleum and Natural Gas Reserves

	Company Share Before Royalties		Company Share After Royalties	
	Crude Oil & NGL's (Mstb)	Natural Gas MMcf	Crude Oil & NGL's (Mstb)	Natural Gas MMcf
Proven Reserves at December 31, 1983	15,760	45,050	13,496	38,500
Additions	5,474	1,613	4,680	1,397
Production	(1,621)	(1,499)	(1,431)	(1,282)
Proven Reserves at December 31, 1984	19,613	45,164	16,745	38,615
Probable Additional Reserves	14,597	5,843	12,714	4,803
Total Proven and Probable Additional Reserves at December 31, 1984	34,210	51,007	29,459	43,418

Present Worth of Future Oil and Gas Net Production Revenue Discounted at:

	0%	12%	15%	20%
		($000)		
Proven Remaining Reserves	820,411	273,376	230,311	181,954
Probable Additional Reserves	802,016	106,399	78,918	51,673
Total Proven and Probable Additional Reserves	1,622,427	379,775	309,229	233,627

Company Share of Production Before Royalties

	1980	1981	1982	1983	1984
Petroleum (bbls)	143,051	211,202	599,550	1,378,094	**1,621,348**
Natural Gas (mcf)	343,623	1,133,914	839,844	1,233,846	**1,498,739**

Financial Review

During 1984, Omega's revenues after royalties totalled a record $52.7 million ($3.92 per share) compared to $45.4 million ($3.28 per share) in 1983, an increase of 16%. The average price received for crude oil in 1984 was $38.60 per barrel and for natural gas was $3.00 per mcf compared to $37.42 and $2.88 respectively in 1983. As indicated, the effects of changes in world oil prices and the pricing fluctuations of Canadian natural gas have not impacted Omega.

Per share figures used on these pages and the Financial Statements are based on the weighted average number of shares outstanding during the year. As shares were purchased in accordance with the Normal Course Issuer Bid approved at the last annual meeting they were removed for purposes of calculating the weighted average number of shares outstanding. Using that calculation, the average number of shares during the year was 13,464,220 compared to 13,076,380 outstanding at December 31, 1984.

Cash flow from operations during 1984 was $30.2 million ($2.24 per share), down 8% from $32.9 million ($2.38 per share) in 1983. For purposes of giving a better comparison of the Company's activities with prior years, the cash flow before provision for income taxes payable was $36.7 million ($2.73 per share) in 1984 compared to $33.7 million ($2.44 per share) in 1983.

Net earnings for 1984 were $17.2 million ($1.28 per share) compared to $18.5 million ($1.34 per share) in 1983, a decrease of 7%.

The decreases in cash flow and earnings are directly attributable to the increasing impact of taxes on Omega, the higher costs related to increasing production and to the Company's active capital program aimed toward future growth.

All expense categories increased in 1984. Production expenses were higher by more than 50% at $6.3 million reflecting costs of new production, maintaining production rates on older wells and waterflood programs at both Waskada and Provost. General and administrative costs were $2.4 million, also more than 50% higher than last year, as a result of staff increases and related costs. Interest on bank loans was 20% higher due to the increase in the average amount of loans outstanding during the year. Provision for depletion and depreciation was up by 26% to $7.8 million as a result of the Company's increased investment in fixed assets.

The greatest impact on the Company's cash expenses and reduced cash flow during 1984 was the tax load. Petroleum and Gas Revenue Tax (PGRT) was $5.4 million, 14% higher than in 1983. This increase results from the Company's higher levels of revenue and the full year effect of the increase in the rate of tax from 14.67% to 16% which occurred on June 1, 1983. To this was added an increase in income taxes payable to $6.5 million from $0.8 million in 1983. Provision for deferred income taxes of $5.2 million is down significantly from the provision of $8.3 million in 1983 which reflects the higher taxes payable. The significance of the Company's increased taxes is a reflection of the harsh taxation policies which encumber the oil and gas industry. The PGRT, which is a revenue tax not deductible in calculating income tax, is a burdensome load imposed only on our industry by the Federal Government. The recent Accord between the Federal and Provincial governments will reduce the burden of PGRT but that will not begin for existing

production until 1986 and it will be 1989 before the tax is eliminated.

Again in 1984, the Company's financial resources have necessarily been largely directed to development of the reserves discovered in previous years. The program in Saskatchewan also qualifies as a development program for purposes of calculating income taxes. For that reason most of the Company's capital expenditures are deductible at only 30% in any one year. At that rate of deduction it is obvious that significant income taxes will result unless the company spends multiples of its cash flow. This is further compounded by the fact that capital cost allowance for expenditures on tangible assets is only available at one-half of the normal rate in the year of expenditure. The development nature of Omega's programs in the past few years is reflected in the increasing taxes payable. As discussed elsewhere in this report, organizational changes have been made which should enable the Company to increase its exploratory activities and thereby ease the burden of current taxes in upcoming years.

Omega's capital expenditures during 1984 reached a record $38.8 million, compared to $35.7 million in 1983. Of the total, $21.3 million was spent on drilling and $13.7 million was spent on production equipment. The drilling expenditure amount is shown before Petroleum Incentive Grants of $4.2 million in 1984 which compares to $4.7 million in 1983. Amounts received under the Incentive Programs are the maximum amounts available because the Company has a Canadian Ownership Rating (COR) under those programs of 98%.

At December 31, 1984, Omega's working capital deficit was down to $1.8 million from $8.3 million at the beginning of the year. The Company's bank loan, which is classified as long term because it is repayable out of future cash flow with no fixed schedule of repayment, stood at $27.8 million compared to $11.2 million at the end of 1983.

The Company's total assets were $109.1 million at December 31, 1984, an increase of 31% from the end of 1983.

Omega Hydrocarbons Ltd.

Consolidated Balance Sheet

As At December 31, 1984

ASSETS

	1984	1983
Current Assets		
Accounts receivable	**$ 7,209,000**	$ 6,914,000
Petroleum Incentives Program claims	**2,231,000**	2,902,000
Income taxes receivable	**605,000**	—
Current portion of notes receivable	**791,000**	1,003,000
	10,836,000	10,819,000
Fixed Assets (note 2)		
Petroleum and gas properties and equipment	**117,441,000**	82,829,000
Accumulated depletion and depreciation	**(19,579,000)**	(11,796,000)
	97,862,000	71,033,000
Other Assets		
Notes receivable (note 3)	**326,000**	1,513,000
Other	**57,000**	146,000
	383,000	1,659,000
	$109,081,000	$83,511,000

LIABILITIES

Current Liabilities		
Bank indebtedness, unsecured	**$ 1,140,000**	$ 2,927,000
Accounts payable and accrued liabilities	**9,986,000**	12,019,000
Petroleum and Gas Revenue Tax payable	**1,525,000**	3,287,000
Income taxes payable	**—**	840,000
	12,651,000	19,073,000
Bank Loans (note 4)	**27,799,000**	11,160,000
Gas Production Prepayments	**519,000**	519,000
Deferred Income Taxes	**18,368,000**	13,172,000

SHAREHOLDERS' EQUITY

Capital Stock (note 5)	**13,163,000**	14,009,000
Retained Earnings	**36,581,000**	25,578,000
	49,744,000	39,587,000
	$109,081,000	$83,511,000

Contingent Liabilities (note 6)

Approved by the Board

Director

Director

Omega Hydrocarbons Ltd.

Consolidated Statement of Earnings

Year Ended December 31, 1984

	1984	1983
Revenue		
Oil and gas sales, net of royalties	**$52,610,000**	$45,252,000
Other	**115,000**	118,000
	52,725,000	45,370,000
Expenses		
Production	**6,345,000**	4,104,000
General and administrative	**2,373,000**	1,485,000
Interest on bank loans	**2,061,000**	1,697,000
Depletion and depreciation	**7,783,000**	6,162,000
	18,562,000	13,448,000
Earnings before corporate taxes	**34,163,000**	31,922,000
Provision for corporate taxes		
Income taxes (note 7)	**11,481,000**	8,670,000
Petroleum and Gas Revenue Tax	**5,445,000**	4,783,000
	16,926,000	13,453,000
Net Earnings	**$17,237,000**	$18,469,000
Net Earnings per Common Share	**$1.28**	$1.34

Consolidated Statement of Retained Earnings

Year Ended December 31, 1984

	1984	1983
Balance at beginning of year	**$25,578,000**	$ 7,109,000
Net earnings	**17,237,000**	18,469,000
Purchase of common shares (note 5)	**(6,234,000)**	—
Balance at End of Year	**$36,581,000**	$25,578,000

Omega Hydrocarbons Ltd.

Consolidated Statement of Changes in Financial Position

Year Ended December 31, 1984

	1984	1983
Working Capital Derived From		
Operations		
Net earnings	**$17,237,000**	$18,469,000
Items not involving working capital		
Depletion and depreciation	**7,783,000**	6,162,000
Deferred income taxes	**5,196,000**	8,263,000
	30,216,000	32,894,000
Bank loans	**16,639,000**	—
Notes receivable	**1,060,000**	1,138,000
Issue of common shares	**—**	186,000
Gas production prepayments	**—**	60,000
Other	**89,000**	—
	48,004,000	34,278,000
Working Capital Applied To		
Fixed assets	**38,831,000**	35,727,000
Petroleum Incentives Program claims	**(4,219,000)**	(4,676,000)
Purchase of common shares	**6,953,000**	—
Bank loans	**—**	2,278,000
Notes receivable	**—**	186,000
Other	**—**	16,000
	41,565,000	33,531,000
Increase in Working Capital Position	**6,439,000**	747,000
Working capital deficiency at beginning of year	**(8,254,000)**	(9,001,000)
Working Capital Deficiency at End of Year	**$ (1,815,000)**	$ (8,254,000)

Notes to Consolidated Financial Statements

Year Ended December 31, 1984

1. ACCOUNTING POLICIES

(a) Principles of Consolidation

The consolidated financial statements include the accounts of Omega Hydrocarbons Ltd. and its wholly-owned subsidiaries, Omega Oil & Gas Ltd. and Omega Oil & Gas, Inc.

(b) Oil and Gas Operations

The Company follows the full cost method of accounting for its oil and gas operations whereby all costs of exploring for and developing oil and gas reserves are capitalized by cost centre. A separate cost centre is established for Canada and the United States. Costs include land acquisition costs, geological and geophysical costs, carrying charges on non-producing property, costs of drilling both productive and non-productive wells, production equipment costs and overhead expenditures related to exploration activities. The carrying value of petroleum and gas properties and equipment may not exceed the aggregate of future net revenues from estimated production of proved reserves at current prices and costs and the estimated fair market value of unproved properties. Capitalized costs are depleted by cost centre using the unit of production method based on estimated proved oil and gas reserves.

(c) Depreciation

Depreciation of other equipment is provided using the declining balance method at rates ranging from 5% to 30% per annum.

(d) Petroleum Incentives

Petroleum incentives which are earned by the Company pursuant to legislation enacted by the Federal and Alberta Governments are recorded as a reduction of the related fixed assets.

(e) Segmented Information

All of the Company's activities are in one business segment, oil and gas exploration, development and production and substantially all of the Company's operations are conducted in one geographical segment, Canada. Accordingly, no separate disclosure has been made of financial data by segment.

2. FIXED ASSETS

	December 31, 1984		
	Cost	Accumulated Depletion and Depreciation	Net
Lease acquisition, exploration and drilling	$ 66,553,000	$12,603,000	$53,950,000
Production equipment and gathering facilities	48,831,000	6,510,000	42,321,000
Other equipment	2,057,000	466,000	1,591,000
	$117,441,000	$19,579,000	$97,862,000

	December 31, 1983		
	Cost	Accumulated Depletion and Depreciation	Net
Lease acquisition, exploration and drilling	$ 47,028,000	$ 7,782,000	$39,246,000
Production equipment and gathering facilities	35,174,000	3,766,000	31,408,000
Other equipment	627,000	248,000	379,000
	$ 82,829,000	$11,796,000	$71,033,000

3. NOTES RECEIVABLE

Under the terms of a share purchase plan, common shares of the Company have been issued to officers and employees in consideration for notes receivable. The notes are non-interest bearing and receivable as follows: 1985 — $791,000; 1986 — $224,000; 1987 — $102,000.

4. BANK LOANS

A line of credit in the amount of $30,000,000 has been established with a chartered bank. Borrowings under this line of credit are on a revolving basis and, at the bank's option, may be converted to a five year term loan. No principal repayments are required in 1985 under the current credit arrangement.

The loans bear interest at the bank's prime lending rate, are evidenced by demand promissory notes and are secured by the Company's interest in certain oil and gas properties and a general assignment of accounts receivable.

5. CAPITAL STOCK

(a) Authorized

The authorized share capital of the Company consists of:

(i) 10,000,000 preferred shares with a par value of $10 each; and

(ii) 60,000,000 common shares of no par value.

(b) Issued

Changes in issued common shares during the two years ended December 31, 1984 were as follows:

	Number of Shares	Consideration
Balance at December 31, 1982	13,815,879	$13,823,000
Increase in promissory notes to reflect change in market price of shares reassigned within share purchase plan	—	120,000
Issued for promissory notes under share purchase plan	6,000	66,000
Balance at December 31, 1983	13,821,879	14,009,000
Cancellation of shares forfeited under share purchase plan	(33,499)	(127,000)
Purchased and cancelled	(712,000)	(719,000)
Balance at December 31, 1984	13,076,380	$13,163,000

(c) Purchased and Cancelled

Pursuant to a Notice of Intention to Make a Normal Course Issuer Bid dated April 4, 1984, the Company advised its shareholders of a program to purchase from time to time up to a maximum of 712,000 of its issued and outstanding common shares. During the year ended December 31, 1984, 712,000 shares were purchased under this program at a cost of $6,953,000. The excess of the cost of the cancelled shares over the stated value of the shares has been allocated to retained earnings.

(d) Shares Reserved

As of December 31, 1984, 754,498 common shares were reserved under the Company's share purchase plan for issue to officers and employees from time to time as determined by the directors of the Company.

Changes in common shares reserved during the two years ended December 31, 1984 were as follows:

	1984	1983
Shares reserved at beginning of year	720,999	726,999
Shares issued	—	(6,000)
Shares forfeited	33,499	—
Shares reserved at end of year	754,498	720,999

6. CONTINGENT LIABILITIES

The Company is contingently liable as guarantor of bank loans totalling $2,069,000 of limited partnerships managed and operated by the Company.

The Company has been named as one of several defendants in a legal action commenced by a limited partner of a partnership managed and operated by the Company. The plaintiff has alleged that certain actions of the defendants constituted a breach of the Partnership agreement thereby entitling the plaintiff to damages. Following the initial trial, the Court of Queen's Bench of Alberta held that the purchase of certain non-producing partnership properties by the Company in 1981 was in breach of the Partnership Act of Alberta. The Court did not consider the question of damages, if any, but directed that the Company is holding these properties in trust for the limited partnership and that certain accountings and enquiries be undertaken with respect thereto. The Company has appealed the judgment. The outcome of this action cannot be determined at this time; accordingly, no provision for damages has been made in the accounts of the Company at December 31, 1984.

7. PROVISION FOR INCOME TAXES

The components of the provision for income taxes are as follows:

	1984	1983
Current income taxes	$ 6,489,000	$ 840,000
Deferred income taxes	5,196,000	8,263,000
Alberta Royalty Tax Credit	(204,000)	(433,000)
	$11,481,000	$8,670,000

Income tax expense differs from the amounts which would be obtained by applying the Canadian statutory federal income tax rate to the respective years' earnings before corporate taxes. The reconciliation of the Canadian statutory federal income tax rate and the effective income tax rate is as follows:

	1984	1983
Statutory federal income tax rate	46%	46%
Royalties and other payments to provincial governments	5	5
Federal resource allowance	(15)	(15)
Investment tax credits	(4)	(10)
Provincial income taxes in excess of federal abatement	3	3
Federal depletion allowance	—	(2)
Federal corporate surtax	—	1
Other	(1)	—
Effective income tax rate	34%	28%

The deferred income taxes represent the income taxes otherwise payable as a result of deducting property, exploration, development and equipment costs for tax purposes in excess of the corresponding depletion and depreciation recorded in the accounts. At December 31, 1984 there were approximately $25,800,000 of unclaimed property, exploration and development costs and approximately $25,400,000 of unclaimed capital costs available to be carried forward.

8. RELATED PARTY TRANSACTIONS

(a) Prior to 1984 the Company entered into a number of farmin and other similar agreements with Alberta Gas Products System Ltd. (AGP), a private company controlled by the president of the Company. Under these agreements, the Company acquired interests in oil and gas properties held by AGP, with AGP retaining an overriding royalty or other interest in the properties.

(b) New North Oil & Gas Ltd. (New North), a private company controlled by the president of the Company, participates with the Company as a joint venture partner in the Provost area.

(c) As at December 31, 1984 accounts receivable include $106,000 due from AGP and New North.

9. STATUTORY INFORMATION

Two directors of the Company received remuneration of $2,000 in their capacity as directors. Remuneration paid to senior officers (including the five highest paid employees) of the Company during the year amounted to $521,000.

Auditors' Report

To the Shareholders of
Omega Hydrocarbons Ltd.

We have examined the consolidated balance sheet of Omega Hydrocarbons Ltd. as at December 31, 1984 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1984 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Thorne Riddell

Calgary, Canada
April 4, 1985

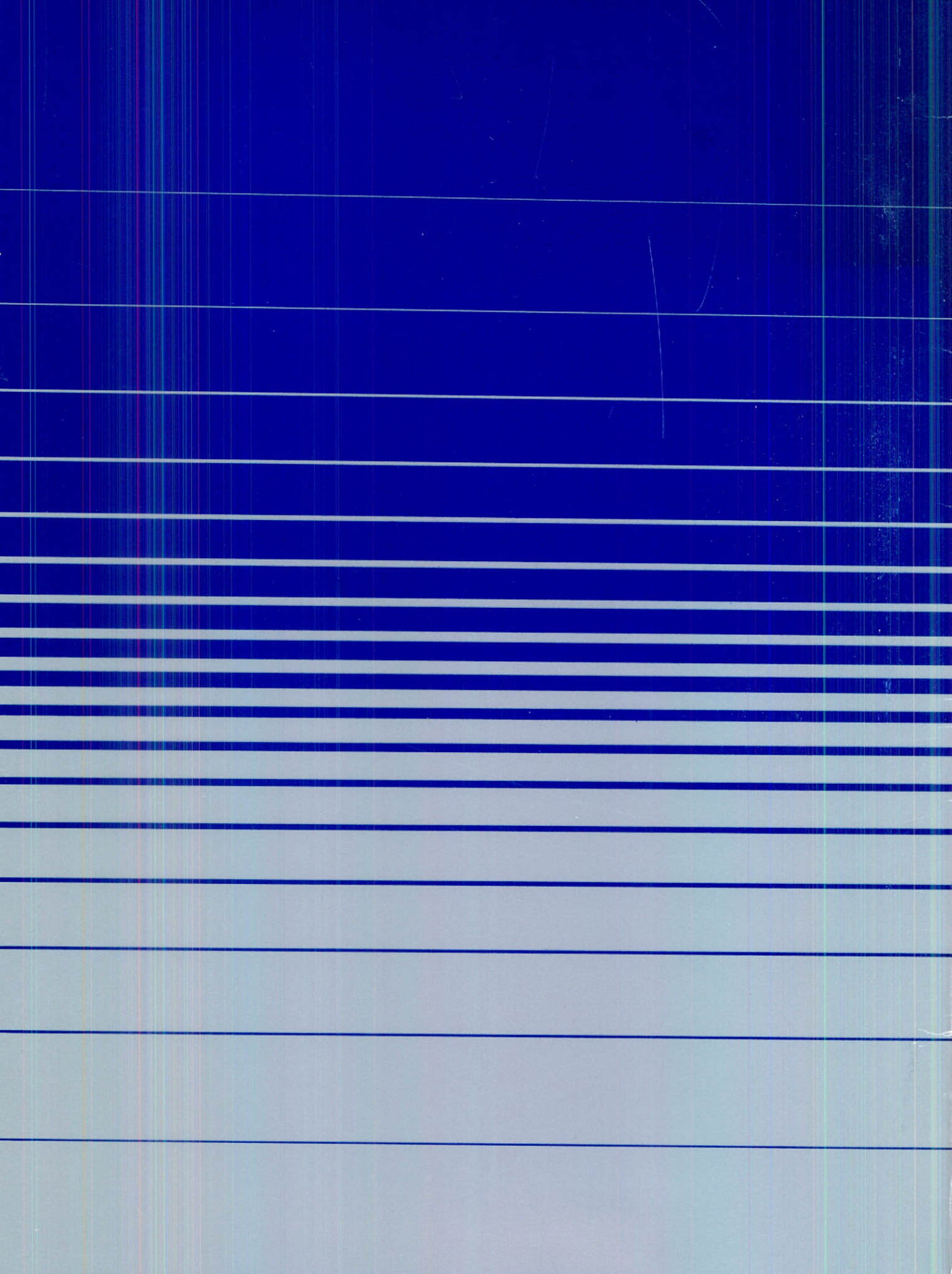
Chartered Accountants

Ten Year Statistical Review

Per share figures and number of shares shown on these pages have been adjusted for the 3 for 1 stock split on December 30, 1982.

	1984 $	1983 $	1982 $
Revenues and Earnings			
Revenues	**52,725,000**	45,370,000	20,730,000
Cash flow from operations	**30,216,000**	32,894,000	13,412,000
— per share	**2.24**	2.38	.97
Depreciation and depletion	**7,783,000**	6,162,000	3,469,000
Petroleum and Gas Revenue Tax	**5,445,000**	4,783,000	2,146,000
Alberta Royalty Tax Credit	**(204,000)**	(433,000)	(521,000)
Income taxes — deferred	**5,196,000**	8,263,000	3,327,000
— current	**6,489,000**	840,000	—
Net earnings	**17,237,000**	18,469,000	6,616,000
— per share	**1.28**	1.34	.48
Balance Sheet			
Working capital (deficiency)	**(1,815,000)**	(8,254,000)	(9,001,000)
Total assets	**109,081,000**	83,511,000	55,171,000
Shareholders' equity	**49,744,000**	39,587,000	20,932,000
— per share	**3.80**	2.86	1.52
Number of shares outstanding December 31	**13,076,380**	13,821,879	13,815,879
Market price per share — high	**13.12**	15.12	9.37
— low	**8.00**	7.12	3.05
Capital Expenditures			
Land	**2,045,000**	1,678,000	2,150,000
Drilling and exploration	**21,699,000**	18,532,000	14,136,000
Production equipment	**13,657,000**	15,517,000	11,538,000
Other	**1,430,000**	—	—
TOTAL	**38,831,000**	35,727,000	27,824,000
Government incentive payments	**(4,219,000)**	(4,676,000)	(2,217,000)
Net	**34,612,000**	31,051,000	25,607,000
Operations			
Proven reserves before royalties			
— Petroleum (barrels)	**19,613,000**	15,760,000	8,419,000
— Natural gas (mcf)	**45,164,000**	45,050,000	36,618,000
Production before royalties			
— Petroleum (barrels)	**1,621,000**	1,378,094	599,550
— per day	**4,430**	3,776	1,643
— Natural gas (mcf)	**1,499,000**	1,233,846	839,844
— per day	**4,096**	3,380	2,300
Land holdings — gross acres	**304,753**	303,411	274,594
— net acres	**216,784**	209,134	187,809
Wells drilled — gross	**153**	137	104
— net	**131**	116	100
Number of employees	**69**	47	33

* not available

1981 $	1980 $	1979 $	1978 $	1977 $	1976 $	1975 $
5,715,000	2,583,000	1,110,000	678,000	627,000	451,000	237,000
2,802,000	1,813,000	718,000	502,000	489,000	331,000	130,000
.21	.15	.06	.05	.05	.04	.02
947,000	287,000	170,000	78,000	71,000	34,000	53,000
431,000	—	—	—	—	—	—
(312,000)	(165,000)	(80,000)	(35,000)	(35,000)	(33,000)	(16,000)
818,000	614,000	220,000	166,000	175,000	118,000	50,000
—	—	—	—	—	—	—
1,038,000	912,000	328,000	268,000	417,000	319,000	88,000
.08	.07	.03	.03	.05	.04	.01
(306,000)	682,000	1,971,000	(106,000)	(167,000)	202,000	3,000
30,084,000	17,203,000	9,669,000	2,950,000	1,096,000	529,000	291,000
14,908,000	9,402,000	8,010,000	1,272,000	886,000	384,000	(5,000)
1.07	.73	.64	.14	.10	.04	—
13,998,078	12,791,718	12,551,718	9,251,718	9,096,468	8,586,468	6,486,468
5.33	3.08	2.79	1.23	1.00	.33	.05
2.58	1.88	.93	.60	.27	.03	.01
3,987,000	410,000	700,000	202,000	176,000	—	—
5,379,000	4,358,000	2,255,000	766,000	218,000	55,000	53,000
3,049,000	3,630,000	1,091,000	154,000	148,000	60,000	63,000
—	—	—	—	—	—	—
12,415,000	8,398,000	4,046,000	1,122,000	542,000	115,000	116,000
(1,228,000)	—	—	—	—	—	—
11,187,000	8,398,000	4,046,000	1,122,000	542,000	115,000	116,000
5,782,000	1,670,000	657,000	*	*	*	*
38,898,000	43,357,000	37,052,000	*	*	*	*
211,202	143,051	50,878	38,948	54,313	38,202	26,776
579	391	139	107	149	104	73
1,133,914	343,623	361,320	204,170	267,182	337,572	199,775
3,107	939	990	559	732	922	547
267,370	226,650	191,638	121,381	*	*	*
171,672	151,185	124,620	99,627	*	*	*
45	51	24	14	2	1	—
35	32	15	6	2	1	—
15	13	8	5	3	2	1

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